

CENTER FOR INSTITUTIONAL REFORM AND THE INFORMAL SECTOR

University of Maryland at College Park

Center Office: IRIS Center, 2105 Morrill Hall, College Park, MD 20742
Telephone (301) 405-3110 • Fax (301) 405-3020

CHAD FINANCIAL SECTOR AND PRIVATE SECTOR FINANCING

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**Roger B. Jantio
Sterling International Group, Inc.
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Author: Roger B. Jantio, Sterling Group International, Inc.
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and
PRIVATE SECTOR FINANCING

Roger B. Jantio
Sterling International Group, Inc.
Washington, D.C.

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Foreword

This paper has been prepared, at the request of the Institutional Reform and Informal Sector (IRIS CENTER) at the University of Maryland at College Park and the United States Agency for International Development (USAID/CHAD.) It is written to synthesize the content of the presentation and debate that took place during the National Seminar on the Promotion of the Private Sector held in N'Djamena last May 1991. It is not intended to be a comprehensive analysis of the financial system reform issues in Chad. The author's sole intention is to bring its perspective on financial stabilization and liberalization in Chad based on preparation for and presentations at a three-day seminar.

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ACRONYMS AND ABBREVIATIONS

AfDB	African Development Bank
AID	Agency for international Development
AMTT	Agricultural Management and Technology Transfer
BDT	Banque de Developpement du Tchad
BEAC	Banque des Etats de l' Afrique Centrale
BIAO	Banque Internationale pour l' Afrique Occidentale
BIAT	Banque Internationale pour l' Afrique au Tchad
BICIT	Banque Internationale pour le Commerce et l'Industrie au Tchad
BKK	Badan Kredit Kacamatan
BTCD	Banque Tchadienne de Credit et de Dépôts
CAR	Central African Republic
CCCE	Caisse Centrale de Cooperation Economique
CCT	Chambre Consulaire du Tchad
GFA	Franc de la Communauté Financiere Africaine
CIFPB	Centre International de Formation de la Profession Bancaire
CNE	Caisse Nationale d' Epargne
COTONTCHAD	Société Cotonniere du Tchad
EIB	European Investment Bank
GBB	Grameen Bank of Bangladesh
GDP	Gross Domestic Product
GOC	Government of Chad
IRIS	Institutional Reform and Informal Sector Center
M2	Money Supply
MCT	Manufacture des Cigarettes du Tchad
OPIT	Office de Promotion Industrielle du Tchad
SMEs	Small and Medium Enterprises
SONASUT	Société Nationale Sucriere du Tchad
s-l-r	Société Tchadienne de Textile
UDEAC	Union Douaniere des Etats d' Afrique Centrale
USAID	United States Agency for International Development
VITA	Volunteers in Technical Assistance

INTRODUCTION

One of the key constraints to improving economic performance in emerging countries is the absence of strong and dynamic financial systems. Healthy capital and credit markets serve the vital roles of mobilizing savings, intermediating funds, and allocating credit to productive uses. Unfortunately, many countries, and Chad is one of them, have repressed financial systems. The purpose of this report is to provide diagnosis and analysis of the Chad financial sector. The project on which this report is based was undertaken on behalf of the INSTITUTIONAL REFORM AND INFORMAL SECTOR, (the IRIS Center), during the National Seminar on the Promotion of the Private Sector held in N'Djamena in late May 1991.

Section I of this paper describes the financial sector in Chad. It is followed by an overview description of the financial constraints, and their effects on small and medium size enterprises. Section III presents recommendations for policy makers and development agencies who wish to address the important topic of financial sector reform in Chad. The last section stresses the role USAID/Chad could play in promotion of the private sector.

I. CHADIAN FINANCIAL SECTOR

Shortage of capital is holding back development of the private sector in Chad. In part, this scarcity is simply a reflection of low income levels (the GDP per capita was only \$150 in 1987, making Chad the poorest country in Africa) and the persistence of large subsistence and non-monetized segments of the economy (see J.F. Hennart's paper presented at the National Seminar.) It also springs from weaknesses in policies and institutions which hamper resource mobilization and restrict the private sector's access to available finance.

1. Characteristics of the Chadian Financial Sector

The Chadian financial sector is characterized by its lack of financial depth. Financial deepening or the ability of a country's formal financial system to mobilize resources can be measured by the evolution of monetary aggregates relative to the Gross Domestic Product (GDP), or by analyzing trends in the evolution of real monetary aggregates over time. Table 1 shows that financial deepening, measured by the monetary supply over the gross domestic product (M2/GDP), is like in many African countries, very low. The lower the ratio, the less developed are the financial systems. In 1987, the financial depth ratio was 25.3% in Chad, (and 21.8% in Mali, 18.1% in Niger, and 23.5% in Senegal.) These low rates for Chad and others imply that the financial sectors do not play their intermediating role of mobilizing liquid resources efficiently at competitive rates of return and of applying them to finance genuinely productive activities.

2. Characteristics of the Supply of Credit

The Chadian financial system is relatively small. In 1986, it generated a total resources of **only about \$650 million, 40% of which were deposits collected from the public, and the remaining** were refinancing from the regional central bank, the BEAC. A diagnosis of Chad supply of credit can be characterized by the following:

a. The Institutions

The financial system is comprised of the **Chadian** branch of the Central Bank of Central Africa (BEAC), and two commercial banks that are closely linked to French banks: the Banque Internationale pour l'Afrique au Tchad (BIAT), linked to Meridien-BIAO bank¹, and the Banque Tchadienne de Cr  dit et de D  p  ts (BTCD), managed by the Credit Lyonnais. These banks reopened their doors between 1981 and 1984, following the civil wars. The postal banking system reopened in 1986.

Three other institutions, crippled by non-performing loans have yet to reopen: the Banque Internationale pour le Commerce et l'Industrie au Tchad (BICIT), the Banque de D  veloppement du Tchad (BDT) and the Caisse Nationale d'  pargne (CNE). These closures have had a demoralizing effect in Chad. Small depositors lost their savings. As a result, a leading banker pointed out in May 1991 that traders are simply using commercial banks to guard their money every night, depositing it in the evening and withdrawing it first thing the next morning. Overall, the key constraint facing depositors is the lack of a basic service: a secure **place** to deposit their money at a real deposit rate.

b. High Concentration of Resources and Credits

Over half of the deposits in Chad belong to about 20 organizations. COTONTCHAD, STT, SONASUT, and MCT are the largest depositors. These organizations are also the largest recipients of bank financing.

Similarly the credit portfolio of the **commercial** banks is also highly concentrated. Over two-third of loan advances are made to COTONTCHAD, with the remaining mostly given to other large enterprises. **Consequently, small and medium enterprises are crowded out of the financial system.** Financial policies and regulations indeed impede credit allocation to **SMEs**, to the **benefit** of large parastatals that have lower risks and preferential access to credit.

¹ BIAO bank was liquidated by its shareholder, the Banque Nationale de Paris. Its African operations were sold to Meridien International Bank Limited.

Table 1:

The Resources of the Banking System: the Deposit Base
As of July 31, 1990
(Millions of dollars)

	BIAT	BTCD	Total	%
Public enterprises	33.8	32.5	66.3	62.5%
Private enterprises	8.8	7.9	16.7	15.8%
Household	5.2	17.9	23.1	21.7%
Total	47.8	58.2	106.0	100.0%

Source: the Study of the financial sector in Chad, by the International Center for Banking Training (CIFPB) of France.

c. The Financial System Emphasizes Short-Term

As in most emerging countries, the credit portfolio of Chadian banks is mainly a short-term one, and undiversified. In 1986, about 97 percent of total credits were short-term advances, mainly crop advances to COTONTCHAD. Financial policies and regulations, the lack of security and collateral, and the insufficiencies of the legal environment penalize any attempt to take a longer-term outlook, and therefore deter longer-term investments. As table 2 shows, BTCD for example has no long-term credits.

Table 2:

Banks' portfolio
As of July 31, 1990
(Millions of dollars)

	BIAT	BTCD	Total	%
Long-term loans				•
Medium term loans	31.7	20.3	52.0	37.5%
Short-term loans	31.7	31.2	62.9	45.3%
Litigation	12.5	11.42	23.9	17.2%
Total	75.9	62.9	138.8	100%

Source: the Study of the financial sector in Chad, by the International Center for Banking Training (CIFPB) of France.

Note: Short-term is less than one year, medium-term is 1-5 years, and long-term is over 5 years.

d. Informal Finance

Chad has over the years established informal financial systems that provide services to the non-corporate sector (households, small farmers, and small businesses.) Informal finance collects resources from a variety of creative instruments such as: 'azouma, pari-vente, tontines', etc. The interest rate on these resources could be over ten times the official rates used by the formal financial sector. A recent study carried out by the University of Chad that has attempted to quantify the importance of informal finance in Chad indicated that informal credit accounted for 84 percent of total loans. With their success in providing financial services to small business that would otherwise lack them, informal financial systems could be interlinked to the formal ones to create new formal financial institutions that would effectively intermediate funds competitively and at low cost. This role is being currently promoted by VITA (see section 3-b.)

3. Characteristics of the Demand for Credit

a. Demand for credit from the Majors

The Chad financial system is specialty geared toward major enterprises and the financing of public expenditure through low administered interest rates and other financial restrictions. This structure has high social costs since it distorts the economy in at least four ways. First, it establishes a bias in favor of current consumption as opposed to saving. Second, it causes disintermediation, because savers are encouraged to invest in their own low-yielding and high-risk instruments (azouma, tontines, etc.) Third, it establishes a bias toward excessive capital-intensive projects and large enterprises such as COTONTCHAD, SONASUT, STT and the BRASSERIES DU LOGONE. Finally, it imposes a high cost on the private sector by squeezing private credit. Overall it hinders the growth of financial systems and impairs mobilization and allocation of financial resources.

b. Demand for credit from Small and Medium Enterprises (SMEs)

Throughout the world, there are examples of banks-the Badan Kredit Kacamatan (BKK) in Indonesia or the Grameen Bank (GBB) in Bangladesh-that provide loans to SMEs at a rate of about 36%, enough to cover their cost of funds, administration costs and costs of risks. These examples show that financial liberalization and stabilization can satisfy the demand of credit.

The VITA project has, to an extent, filled the gap by providing some financing to SMEs. Supported by A.I.D., it has granted over 190 loans averaging \$11,500 to \$17,000 to SMEs and \$1,000 to informal microenterprises, and generated 568 jobs during its 6-7 years of operation. Approximately 85 percent of loans are reimbursed on time, and loan defaults are estimated at less than 6 percent. For informal microenterprises, loan reimbursement is 100 percent. VITA bundles credit and technical assistance to the business person seeking a loan. This explains its success in terms of performing loans. The cost of the technical assistance is high, and the operation will not be able to generate enough income to break-even for many years. In addition to the cost of

technical assistance, the interest rate VITA charges is well below commercial rates of 22-24 percent. VITA is negotiating with the Chadian government to increase its rates to about 14-18 percent. VITA also charges fixed and non-refundable application fees to defray the cost of technical assistance, which when added to the interest rate is equivalent to approximately a 20 percent rate. VITA is launching a micro-enterprise lending program with the BTCD, as part of its strategy of lending to a relatively small number of formal businesses in Chad.

ii. FINANCIAL CONSTRAINTS

Four financial constraints are here examined: first, financial market regulations which reduce savings deposits and discourage banks from lending to **SMES**; second, the crowding-out of the private sector from financial markets by excessive borrowing by the Chadian government and public enterprises; third, heavy taxation which squeezes corporate **profits** and entrepreneurial incomes and therefore limits the capacity to generate internal investment funds; and fourth public investment programs which monopolize the use of foreign loans and grants.

1. Financial Market Regulations

An analysis of interest rate policy in Chad from 1970 to 1983 revealed that by and large nominal interest rates were set by regional central bank (BEAC). Rates changed little over time, and hence real rates were primarily determined by variations in the rate of inflation. A joint UNDP/World Bank study on 'African Economic and Financial Data' determined that in 1987, annual inflation was estimated to be 6.5 percent. The deposit rate was 5.33 percent. Real deposit rate was negative, thus encouraging an outflow of funds from the **formal** financial systems. As a result, total domestic credit that could be made available to borrowers by the monetary authorities and banks expanded slowly in real terms.

2. Crowding-Out by Public Sector Borrowing

The private sector's access to bank credit has been restricted because the government and public enterprises have been given first claim on financial resources, both foreign and domestic. Centre International de Formation de la Profession Bancaire (CIFPB) data show that the public sector's share of outstanding domestic credit from the monetary authorities and banks topped 89 percent consistently since the reopening of the banks. In Botswana and Cameroon, two more successful economies, the governments have been net lenders rather than borrowers of domestic **financial** resources.

The Government of Chad's (GOC) demand for domestic credit increased for three basic reasons.

First, the growth of expenditure on public investment and current services outpaced the growth of revenue, resulting in widening budgetary deficits. Excluding grants, the deficits were 9.5 percent of the GDP in 1986, and 18.5 percent in 1987. Second, the income of public enterprises did not cover their operating costs. The gap was filled by additional loans provided directly by the banking system or by government subsidies, which in turn were financed by government borrowing. Third, despite its low debt ratio (3.9 percent in 1987) the Chad financial rating is low and makes it impossible for the government to borrow in international commercial markets. It therefore drew more heavily on private domestic savings to meet its financial needs.

The government is becoming aware of the negative effects of budgetary deficits and heavy public borrowing on private sector opportunities and the efficiency of resource utilization in the economy as a whole. (See excerpts of Mr. Prime Minister Alique's speech at the closure of the Seminar). Steps were taken in the context of the structural adjustment programs to curb the public sector's financial appetite. These measures included: (1) reducing losses of, and subsidies to, public enterprises (mainly COTONTCHAD) and (2) eliminating budgetary deficits by raising tax revenues. The GOC and the World Bank would like to achieve this without negative repercussions by broadening the tax base or improving the tax collection. As discussed more fully in the Taxation section below, there are risks that imposing higher marginal tax rates on firms which are already heavily burdened by taxes may be counterproductive: encouraging tax evasion and expanding the informal sector base; and squeezing profits which could have been ploughed back into the business to expand capacity, raise productivity or diversify output.

3. Heavy Taxation Squeezes Corporate Profits and Entrepreneurial Incomes

There are over 80 different taxes in Chad (corporate tax, sales tax, apprenticeship tax, property tax, "patente", etc.) with often a high rate. For example the rate of tax on corporate income is 50% of the taxable profit, more than in other African countries.

Rates of personal income tax are also high in Chad, and have low income thresholds. High corporate and personal income taxes have had three negative effects. First, they have reduced the private sector's capacity to accumulate reserves. Second, they diverted entrepreneurial efforts from formal productive activities, where financial transactions are more readily audited, to speculation, trading and 'underground' activities where earnings can be more easily hidden from the tax authorities. Third, high tax rates have increased the pressures for corruption of lowly-paid tax officials. Widespread corruption for example, has undermined the role of the custom office in N'Djamena.

The net result of this heavy taxation has been a contraction of the tax base and lower tax revenues. GOC attempts to stem the fall in revenues by raising tax rates still further have only accelerated the decline. Chad introduced a series of tax measures such as the tax of 2 percent on any bank loan, to take account of rapid inflation and cost increases. Consequently the tax burden on those individuals and private enterprises which abide by the tax laws has increased sharply, while the actual tax revenues dropped.

A reappraisal of tax and custom duty *policy* is underway in Chad. A *recent* World Bank fiscal mission has recommended that the custom system be revamped. The mission investigated ways to improve the responsiveness of the tax system and its efficiency, i.e., to remove disincentives for savings and distortions in resource allocation. Indeed during the Seminar on the Promotion of Private Enterprise in Chad, the workshop on taxation recognized that the fiscal regime discriminated against private enterprises by exempting some parastatals from the turnover tax.

4. A large Number of Enterprises is not "Bankable"

Chad is traditionally a country of traders. Since the colonization days, large trade was oriented toward France, Nigeria and the neighboring French-speaking country of Cameroon. This orientation has intensified towards Nigeria, since almost all foreign-owned companies left Chad during the civil wars and did not return. Apart from about 20 enterprises, Chad private sector is comprised of a multitude of small and informal microenterprises in commerce, transport, manufacturing and construction. Because small and medium scale enterprises (SMEs) are considered high risk, the criteria used by commercial banks to make loans to them are strict, resulting in a severe lack of capital financing.

III. RECOMMENDATIONS TO IMPROVE THE FINANCIAL SECTOR ROLE

Financial distress is acute in Chad because of the consequences of civil wars, a poor macroeconomic and fiscal environment, unfavorable external circumstances, problems in productive sectors of the economy, and mismanagement in the financial sector itself.

1. Financial Sector Development: Policies and Issues

a. Deficit Finance and the Health of the Financial Sector

The Private Sector Seminar concentrated on longer-term institutional development and the manner in which Chad might seek to extend and strengthen its financial systems to better support longer-term **economic** development. **Within this general** theme, the **focus** was on government deficits and **parastatal** financial needs that are **currently** being financed by captive sales of **securities**, or alternatively, by **relatively** less appeal of the competing private sector securities. In the latter case, the desired result is achieved using a variety of instruments such as transaction taxes, stamp duties, interest rate and credit ceilings, and high reserve requirements. Successful financial restrictions of these and other types together enable a public deficit to be financed at a lower rate of inflation and with lower nominal interest rates.

The Chadian government has made some efforts to offset some of the worse consequences of the private sector credit squeeze through policies such as priority credit allocation to **specified** sectors. In practice, these practices are of dubious value. In particular, selective credit policies and directed credit programs reduce the flexibility of financial systems and require that it be kept segmented and restricted. This increases the fragility of Chad financial institutions by requiring them to expand their exposure in particular areas beyond the limits of what a commercial risk to return calculation would show to be justified.

b. Exchange Rate

Chad is a member of the Bank of Central African States (BEAC) and shares the same currency as Cameroon, the Central African Republic (CAR), Equatorial Guinea, Gabon and the Congo. As a member of BEAC monetary zone, Chad cannot solely adjust its exchange rate, **which** is pegged to the French franc.

The issue of an overvalued exchange rate was discussed extensively at the Seminar. and the general sentiment that emerged was that an effective exchange rate policy and 'getting prices right' were not a panacea, but as one participant suggested, getting prices wrong certainly would not help. This was especially the case today, when the Naira, the Nigerian currency, is **market-**driven and flexible, thus making Nigeria a tremendous source of imports of both legitimate and fraudulent goods. As a **result** the Chad formal sector has comparative disadvantages that in turn affect the viability of the formal financial systems,

Most participants did not support use of the exchange rate as a means of enhancing the international competitiveness of Chad production. They expressed concern about low price elasticities of demand of Chad exports. Participants also argued that the high import content of Chad production negates or **significantly** reduces the impact of devaluation on the profitability of tradeables. This suggests a perception that most productive activities (including traditional export such as cotton) are **characterized** by zero or negligible value added at Nigeria/Cameroon prices (Chad's main trading partners.)

There was a consensus for a 'depoliticization of the exchange rate.' As the 1992 deadline for full European integration is approaching, France is becoming less and less committed to supporting a fixed parity between the CFA and the French franc. Consequently the necessity of a realistic exchange rate becomes pressing. Chad, like other francophone African countries, will have to endorse the use of an active exchange rate policy as an instrument for equating supply of and demand for foreign exchange.

2. *Management of the Banking Sector and Financial Sector Reform*

Financial systems in Chad are dominated by banking systems which hold 95 percent of the assets of all financial intermediaries. The market is controlled by two commercial banks. Their size is based not on economies of scale, but on restrictions on interest **rate** and credit controls that discourage competition.

Ways in which the banking sector can promote financial reform include improved operations that bundle banking and advisory services. OPIT, a **Chadian** government organization that should support the private sector, does not have financial, administrative, and technical experience and, has indeed been largely ineffective. The ability of banks to offer technical assistance to selected clients could prove decisive in attracting such market segments as the 'VITA graduates', and other **SMEs**.

As part of the internal financial infrastructure, **Chadian** banks should ensure the confidentiality of banking transactions. Confidence is needed to attract some mainstream and quasi-mainstream bank customers who 'downgraded' to the informal financial system after being overtaxed by the government during the civil wars-through access to bank data, the government levied 'war taxes' in an arbitrary manner.

3. *New Institutions: The Rehabilitation of the Development Bank*

a. The Risks of Reopening BDT

The African Development Bank (**AfDB**) has put forward a program to rehabilitate BDT, Chad's state-owned development Bank. In other African countries, development banks have failed. Indeed, ill-conceived macroeconomic policies such as those involving directed credit programs often use development financial institutions as their channel and so directly hamper the sound working of such institutions. Such a system might be able to avoid this fate if as, for example, in the case of Taiwan, the overly bureaucratic management practices in the public banks do little harm to economic performance because of **generally** sound macroeconomic policies. In the case of Chad financial liberalization, and not the reopening of BDT with a high level of non-performing assets in its portfolio, is needed.

In addition, with a little financial deepening and limited demand of credit from formal sources, there is little market left for a rehabilitated BDT. VITA has, with some success, started to call on possible BDT customers, but is yet to break-even. In addition, **BIAT** and **BTCD** have not used the credit line extended to them for long-term development projects by the European Investment Bank (EIB) and the French Caisse Centrale de Cooperation Economique (CCCE).

b. Alternative Solutions to BDT

An alternative to BDT could be the creation of a cooperative bank or a credit union. The Banque Populaire du Rwanda (BPR) offers, a model example. Through aggressive outreach programs, BPR has captured about 25 percent of the deposit base. With its in-country branches, It has become a viable vehicle for popular resource **mobilization** and serves as the financing agent for microenterprises.

Along the same line, VITA's graduation to the micro-enterprise market and **the** continued support it receives from A.I.D. offer an effective and efficient alternative to BDT.

4. Promotion of an Economic Climate Conducive to Financial Development

As the government of Chad is determined to persevere with reforms, it is crucial that an enabling macroeconomic environment exist. Such an environment must be free of destabilizing macroeconomic policies, and must be one in which formal financial transactions prevail. This tends to encourage greater mobilization of domestic savings and their efficient allocation, and to assist in the integration of fragmented informal credit markets into the formal financial system. In reality, statutory regulations in Chad still impose low or negative real interest rates on bank deposits which combine to other policies, deflect financial savings away from the banking system. These policies make for highly inefficient linkages between the supply of savings and the demand for investment, and consequently for low growth rates.

Chad must also build its financial infrastructure, including information, regulatory and legal systems. To a certain extent, the information system and a system of prudent regulation and supervision are supported by the BEAC. For example, the local branch of BEAC has a data base on corporate risk that lists non-performing loans by name. This is an example of the information needed by financial institutions and markets in their decision-making processes. However, the data at BEAC need to be upgraded by better implementation of accounting and auditing rules.

There must also be adequate legal protection for both debtors and creditors. In Chad, the corporate laws, the banking laws and the bankruptcy laws are weakly enforced. Rights and responsibilities under financial contracts must be clearly spelled out and enforced, and in Chad they are not. A leading banker in N'Djamena pointed out that in the last 6-7 years, only five commercial litigations have been successful. This is an important area for further work.

IV. ROLE OF USAID/CHAD IN PROMOTING CHADIAN'S FINANCIAL SYSTEMS SECTOR

The Seminar demonstrated clearly that there is no shortfall of entrepreneurial spirit in Chad. Indeed, some businesses did not even stop functioning during the various wars. The most crucial limiting factor is not entrepreneurship, but weaknesses in the physical and policy environment which inhibit effective development. USAID/CHAD existing programs make significant contributions. They could be reinforced by placing greater stress on the easing of regulatory controls and closer collaboration with the private sector. The Private Sector Seminar stressed six main factors that contribute to an enabling environment:

- macroeconomic conditions and policies
- * incentives for private producers and consumers
- legal and regulatory framework within which the private sector operates
- efficacy of public sector institutions
- physical and social infrastructures
- efficiency with which the **Chadian** financial sector mobilizes and intermediates financial resources.

1. Policy Reforms

A favorable policy environment is a prerequisite to the growth of the private sector in Chad as well as in other African countries. Policy reforms can remove constraints on entrepreneurial activity. Liberalization of the financial market, widening of domestic credit, reduction and harmonization of import tariffs, removal of quantitative restrictions on trade, and lifting of excessive bureaucratic procedures and requirements, are all difficult but necessary steps to improve the business climate. As was confirmed during the Seminar by private sector representatives, without such reform, necessary business confidence will not materialize.

2. Policy Dialogue with the Private Sector

The new government in Chad has shown commitment to a reform process. USAID can facilitate the implementation of the reform. In its economic and sector analysis work, USAID can help to identify constraints and, through comparative, cross-country studies, draw the attention of policy makers to measures which have been successfully applied to overcome these constraints. By doing so, USAID will strengthen both its own analytical capacity and local Chadian resources for implementation of reforms by involving the private sector more closely in its policy dialogue.

As USAID is taking a front seat in the preparation of the Donor Conference on Chad, consultation with private entrepreneurs and managers, and with representative organizations such as the Ghambre Consulaire du Tchad (CCT), could enhance the recognition of USAID as a vital partner in the Chad private sector development process.

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